

Before the  
Federal Communications Commission  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Review of the Section 251 Unbundling	)	CC Docket No. 01-338
Obligations of Incumbent Local Exchange	)	
Carriers	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions of the Telecommunications Act of	)	
1996	)	
	)	
Deployment of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	
	)	

REPLY COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.

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**REPLY COMMENTS OF QWEST COMMUNICATIONS**  
**INTERNATIONAL INC.**

Qwest Communications International Inc. ("Qwest") respectfully submits its Reply  
Comments in the above-captioned proceeding.<sup>1/</sup>

**INTRODUCTION AND SUMMARY**

The unequivocal evidence in the record demonstrates that competing providers increasingly can and do self-provision many facilities or otherwise obtain them from non-incumbent sources and thus would not be impaired without access to certain ILEC network elements. In their comments, CLECs such as AT&T and WorldCom essentially suggest that the Commission ignore this evidence. Indeed, far from acknowledging that increased facilities-deployment and intermodal competition might at least in some cases require removal of unbundling requirements, a number of CLECs insist that the Commission should *add* even more

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<sup>1/</sup> Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 16 FCC Rcd 22781 (2001) ("Notice").

such requirements.<sup>2/</sup> They do so in part by urging that the Commission interpret and apply the necessary and impair standard so that it would once again fail to impose any meaningful limitation.<sup>3/</sup> And, perhaps recognizing that a claim of impairment would not be credible in at least some cases no matter how the standard is defined, CLECs advocate a variety of creative routes through which, they assert, the Commission (or state commissions) can and should evade or simply disregard the statutory standard altogether.

Even if the CLECs' arguments had any force before the D.C. Circuit's decision in *United States Telecom Ass'n v. FCC* (and they did not), that decision has now made clear that the Commission should reject the CLECs' entreaties.<sup>4/</sup> In finding that the Commission's current unbundling and line sharing rules are inconsistent with the 1996 Act, the court adopted several key holdings that must guide the Commission in this proceeding, and that generally accord with both Qwest's initial comments and many of the Commission's proposals in the *Notice*:

1. In passing the 1996 Act, Congress did not adopt the position that "more unbundling is better."<sup>5/</sup> To the contrary, unbundling "imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities."<sup>6/</sup>
2. The Commission cannot adopt unbundling rules that make UNEs available in markets "where there is no reasonable basis for thinking that competition is suffering from any impairment of a sort that might have [been] the object of

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<sup>2/</sup> To its credit, Sprint does recognize the need to relax at least some unbundling requirements. Sprint Comments at 49-51 (explaining that CLECs are not impaired without access to unbundled ILEC signaling and most call-related databases).

<sup>3/</sup> See *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 388 (1999) ("[T]he Act requires the FCC to apply *some* limiting standard, rationally related to the goals of the Act.").

<sup>4/</sup> *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002).

<sup>5/</sup> *Id.* at 425.

<sup>6/</sup> *Id.* at 427.

Congress's concern."<sup>7/</sup> Such a market-based analysis must take into account whether an element has been competitively deployed in the market by non-ILEC providers.<sup>8/</sup> In addition, the impairment analysis must factor in the effects of cross-subsidization in retail rates. For example, the Commission's nationwide unbundling rules were unlawful in part because they failed to account for the advantages enjoyed by CLECs in markets where ILECs are forced to charge above-cost rates "in order to offset their losses in . . . subsidized markets."<sup>9/</sup>

3. The Commission may not find impairment on the basis of cost disparities, including economies of scale, that new entrants typically face in any industry. As the court noted, "average unit costs are necessarily higher at the outset for *any* new entrant into virtually any business."<sup>10/</sup> A cost disparity can justify a finding of impairment only if "the cost characteristics of an 'element' render it . . . *unsuitable for competitive supply*,"<sup>11/</sup> and this requires analyzing economies of scale "over the entire extent of the market."<sup>12/</sup>
4. In determining whether an element should be unbundled, the Commission must take into account the existence and extent of intermodal competition. As the court concluded, the 1996 Act does not permit "the Commission to inflict on the economy the sort of costs noted by Justice Breyer [in *Iowa Utilities Board* that result from unbundling] under conditions where it had no reason to think doing so would bring on a significant enhancement of competition."<sup>13/</sup>
5. The impact of the Commission's unbundling rules is undeniably intertwined with the prices at which UNEs are made available. As the court stated, "low UNE prices would not only have the direct effect [of diminishing incentives to invest] but would inherently tend to expand the sphere of these effects . . . [E]ven prices

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<sup>7/</sup> *Id.* at 422.

<sup>8/</sup> *See id.* at 429 (finding that the Commission's impairment analysis for line sharing improperly failed to consider facilities-based competition); *see also id.* at 423 (noting the Commission's failure to consider the significance of CLEC facilities deployment in markets with above-cost rates).

<sup>9/</sup> *Id.* at 422.

<sup>10/</sup> *Id.* at 427.

<sup>11/</sup> *Id.* (emphasis added).

<sup>12/</sup> *Id.* (quoting 2 Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* 119 (1989)).

<sup>13/</sup> *Id.* at 429.

that are set within the band of what is lawfully permissible may have perverse effects, and the Commission may be obligated to consider them.”<sup>14/</sup>

Faithful application of the court’s holdings to the record in this proceeding compels a significant reduction in the scope of the unbundling requirements. The record establishes both that CLECs increasingly are able to provide service over their own facilities or those obtained from non-ILEC sources and that intermodal competition has continued to grow significantly. As Qwest and others demonstrated in their initial comments, these developments compel the removal of switching and, in many areas, dedicated transport from the list of required UNEs. CLECs are relying on self-provisioned switches throughout the country and have deployed facilities that can serve the vast majority of BOC access lines. Moreover, contrary to CLECs’ suggestions, ILECs such as Qwest perform hot cuts on a timely and cost-efficient basis. Marketplace evidence similarly demonstrates that competition would not be impaired by the absence of access to ILEC dedicated transport, at least in areas that meet the Commission’s pricing flexibility test.

The Commission also should reject out of hand CLEC proposals to *expand* unbundling obligations. This is particularly critical in the case of facilities used to provide advanced services. Increased regulation in the form of added unbundling requirements would serve only to discourage investment and suppress the development of relatively nascent and highly competitive advanced services markets. AT&T, WorldCom, and other CLECs ask the Commission to reverse its prior determinations that DSLAMs and packet switches generally should not be unbundled, and posit a host of additional potential harms that they claim would justify a variety of ill-defined, new requirements. But the CLECs’ advocacy flies in the face of the evidence demonstrating the increased investment in and availability to them of non-ILEC

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<sup>14/</sup> *Id.* at 425 n.2.

advanced services facilities. And the CLECs' position virtually ignores the presence of the substantial intermodal competition recognized as critical by the D.C. Circuit, as well as the damage that imposing additional regulation would inflict on DSL's ability to remain a viable competitive alternative to dominant yet paradoxically unregulated cable modem service. Indeed, in light of the competitive advanced services market, DSL's second-tier status in that market, and the *USTA* decision, the Commission should not only refuse to increase unbundling obligations in connection with facilities used to provide advanced services, but also decline to reinstate the line sharing obligations that the court vacated.

These reply comments are divided into four parts. Part I elaborates on the analytical approach the Commission should use in determining whether an element should be unbundled, particularly in light of the decision in *USTA*. Part II explains how this framework requires the removal of both switching and, in markets that meet the Commission's pricing flexibility test, dedicated transport from the list of required UNEs. Part III shows why CLEC calls to *increase* unbundling requirements, especially as to facilities used to provide advanced services, have no basis in law or fact. Finally, Part IV, in light of this Commission's and the D.C. Circuit's recognition of the close relationship between the list of UNEs to be unbundled and UNE pricing, identifies several critical clarifications the Commission should provide to ensure that TELRIC is applied in accordance with the Commission's original intentions and does not further damage the prospects for facilities-based competition.

## **I. ANALYTICAL FRAMEWORK**

### **A. The Impairment Analysis**

At bottom, the focus of the Commission's inquiry under the "necessary and impair" test of Section 251 must be whether, without cost-based access to a network element, competitors

would face entry barriers significant enough to prevent meaningful competition in the retail market. If the answer to that question is “no,” then requiring that the element nevertheless be unbundled at cost not only would be contrary to the 1996 Act, but would affirmatively harm the development of competition by “spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities.”<sup>15/</sup> Indeed, as the D.C. Circuit recognized, courts and commentators reached the same conclusion in the context of antitrust law well before passage of the 1996 Act.<sup>16/</sup> These commentators have recognized that, where competitors “could enter the market by some alternative not requiring sharing of the [monopolists’] facility,” forced sharing would “reduc[e] the incentive for development of *realistically available* competitive alternatives.”<sup>17/</sup> And that in turn would reduce the range of competitive alternatives available to consumers for the simple reason that “firms that share existing facilities do not compete in respect to the facilities that they share.”<sup>18/</sup>

The same underlying economic considerations should lead the Commission to limit unbundling obligations to those bottleneck facilities that, as the Supreme Court described in *Verizon*, are, at least for now, “unlikely to be duplicated.”<sup>19/</sup> As explained below, where marketplace evidence shows that competitors *already have* duplicated certain types of facilities, or *could* realistically and economically duplicate them even in markets where the competitors

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<sup>15/</sup> *Id.* at 427. If the answer to this question is “yes,” then, as discussed below, the Commission must decide whether unbundling the element in question would nevertheless conflict with the objectives of the Act, including development of facilities-based competition.

<sup>16/</sup> *Id.* at 426.

<sup>17/</sup> Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 771b (2002) (*emphasis added*).

<sup>18/</sup> *Verizon Communications v. FCC*, 122 S. Ct. 1646, 1672 n.27 (2002) (quoting *id.* at 1693 (Breyer, J., dissenting)).

<sup>19/</sup> *Id.* at 1668 n.20.

have not yet chosen to do so, that should be sufficient to end the inquiry. In other cases, the Commission will need to apply its analytical framework, but it should do so only with an appropriate weighting of factors, not, as WorldCom suggests, by relying primarily on cost or any other single factor.<sup>20/</sup> In all events, the Commission should *not* accede to the various CLEC proposals that would require that an element be unbundled even if meaningful competition is possible without such forced sharing.

**1. Evidence of Competitive Deployment of a Network Element Is the Best Indication that CLECs Would Not Be Impaired Without Access to that Element.**

As Qwest demonstrated in its initial comments, evidence that CLECs have deployed a network element, by definition, demonstrates that they can and do provide service without access to that element from the incumbent's network and that the element accordingly is not a bottleneck without which CLECs would be impaired.<sup>21/</sup> That is all the more clear after the decision in *USTA*, in which the D.C. Circuit emphasized the importance of explaining how a finding of impairment for an element could be justified in the face of evidence of deployment of competitive alternatives in a particular market.<sup>22/</sup> Simply put, as Professor Joseph Farrell, former Chief Economist at the Commission, explains in his attached declaration, "the fact that one or more alternative suppliers are providing an element is itself strong evidence that entry barriers do not preclude efficient competitors from supplying the element in question."<sup>23/</sup>

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<sup>20/</sup> See WorldCom Comments at 51 (arguing that "cost is perhaps the most important factor forcing CLECs to depend on ILEC facilities").

<sup>21/</sup> Qwest Comments at 11-12; *see also* Declaration of Joseph Farrell (submitted as Attachment A to these comments) ¶ 17 ("Farrell Declaration").

<sup>22/</sup> See *USTA*, 290 F.3d at 428-29.

<sup>23/</sup> Farrell Declaration ¶ 17.

Nevertheless, AT&T suggests that the Commission should discount evidence that CLECs have deployed certain types of facilities. According to AT&T, even if these facilities exist and have been deployed by a CLEC, the actual utilization level of the facilities by the CLEC may be low in some cases, thereby raising the CLEC's cost of providing service.<sup>24/</sup> This claim is highly ironic in light of AT&T's insistence in UNE cost proceedings that there are virtually no limits on the extent to which utilities will share facilities with one another to achieve economies of scale and reduce costs.<sup>25/</sup> Indeed, Professor Farrell observes that the existence of competitive alternatives provides the opportunity for entrants to "share in the *alternative supplier's* economies of scale."<sup>26/</sup> But, in any event, the fact that existing CLEC facilities are operating at less than capacity would not demonstrate that absence of access to the ILEC's facility would impair competition. If anything, it shows just the opposite: CLECs can use those existing facilities to serve new customers without having to rely on ILEC facilities. Moreover, the existence of unused capacity on a CLEC's facilities means that there is additional non-ILEC capacity available for use by *other* CLECs.

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<sup>24/</sup> See, e.g., AT&T Comments at 207 (claiming that "AT&T's local voice switches are still significantly below an efficient usage level, meaning that AT&T cannot achieve the same efficiencies as the ILECs when it uses its own switches").

<sup>25/</sup> See, e.g., Joint Reply Post-Hearing Brief of WorldCom, Inc. and AT&T on Pricing Issues, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket No. 00-218, at 76 (filed Jan. 31, 2002) (arguing that, in a competitive environment, "the percentages of shared structure will dramatically increase as carriers and utilities seek to share more facilities on structures to save costs and an efficient carrier's incentives to engage in structural sharing increase").

<sup>26/</sup> Farrell Declaration ¶ 17.

**2. Cost Disparities Can Support a Finding of Impairment Only When the Cost Characteristics of an Element Render It Unsuitable for Competitive Supply.**

The D.C. Circuit's decision in *USTA* and the attached Declaration of Professor Joseph Farrell make clear that, in the *UNE Remand Order*,<sup>27/</sup> the Commission placed too much emphasis on cost disparities. The court observed that "average unit costs are necessarily higher at the outset for *any* new entrant into *virtually any business*."<sup>28/</sup> But that standard cost of entry does not justify requiring unbundled access to a network element under the "necessary and impair" standard of the 1996 Act.<sup>29/</sup> To comply with the court's decision, an alleged cost disparity can only support a finding of impairment only where "the cost characteristics of an 'element' render it at all unsuitable for competitive supply."<sup>30/</sup> In other words, so long as it is possible, at some reasonable point in the future, for CLECs to achieve economies of scale with respect to a particular element that would make the CLECs' costs comparable to the ILECs' costs, the fact that the CLECs' costs for an element at the time of entry may be higher than the ILEC's does not justify a finding of impairment.

Thus, as Professor Farrell explains, "[i]f an element displays only ordinary economies of scale, the Commission should not require its unbundling unless that element also exhibits certain *additional* features that (perhaps in conjunction with the scale economies) create true entry

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<sup>27/</sup> Third Report and Order and Fourth Further Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 15 FCC Rcd 3696 (1999) ("*UNE Remand Order*").

<sup>28/</sup> *USTA*, 290 F.3d at 427 (emphases added).

<sup>29/</sup> *Id.* at 426-27.

<sup>30/</sup> *Id.* at 427.

barriers.”<sup>31/</sup> The proper inquiry should include factors such as (1) the relative size of sunk costs associated with an element as compared to ongoing costs, (2) the rate of innovation with respect to an element, (3) the relative cost of an element as compared to the cost of its complements; and (4) whether the element has been supplied by competitors. In many cases, analysis of these factors can lead to the conclusion that, despite even significant economies of scale, competitors would not be impaired without access to unbundled ILEC facilities. For example, where sunk costs are relatively small compared to ongoing costs, “entrants may . . . be able to vie effectively against the incumbent, whether customer-by-customer or in pursuit of the economies of scale.”<sup>32/</sup> Likewise, an element subject to rapid innovation is likely to be replaced far more frequently and thus “potentially provid[e] many inflection points at which an entrant whose innovation outperforms an incumbent’s may succeed despite other potential obstacles such as economies of scale.”<sup>33/</sup> And the fact that a particular element is relatively inexpensive as compared to its complements also would indicate that economies of scale with respect to that element have less impact on an entrant’s ability to compete than economies of scale with respect to more costly elements.<sup>34/</sup>

Finally, to the extent that the cost component of the impairment analysis requires a comparison of the cost of self-provisioning an element (or otherwise obtaining the element from non-ILEC sources) with the cost of obtaining it from the ILEC, it is critical that the Commission apply the correct standard in determining the latter. As the D.C. Circuit explained, “the closer

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<sup>31/</sup> Farrell Declaration ¶ 12.

<sup>32/</sup> *Id.* ¶ 13.

<sup>33/</sup> *Id.* ¶ 14.

<sup>34/</sup> *Id.* ¶ 15.

the Commission's pricing principle is to the low end of what it may lawfully set, the greater the probability that lack of access would cause 'material diminution'" under such a standard.<sup>35/</sup> But lower UNE prices, even if within the TELRIC range, "inherently tend to expand the sphere" of the negative effects of unbundling — "reduc[ing] the incentives for innovation and investment in facilities."<sup>36/</sup> Thus, a greater cost disparity resulting from a low UNE price, even if superficially suggesting a greater likelihood of impairment, may simultaneously indicate a greater chance that unbundling will suppress innovation and investment. And, as discussed below, the Commission is obligated to consider those offsetting effects in determining whether an element must be unbundled.

In all events, as explained in Qwest's initial comments and in more detail below, the distortions in make/buy decisions caused by unbundling are becoming more acute as states increasingly misapply TELRIC and set UNE rates not at the low end of the TELRIC range, but below it.<sup>37/</sup> The Commission should provide additional binding guidance so as to prevent these misapplications of TELRIC that inevitably will distort market signals and significantly hamper the development of facilities-based competition. *See infra* Part IV.

### **3. The Implicit Subsidies Inherent in Retail Rates, Far From Supporting a Finding of Impairment, Weigh Against Such a Finding.**

CLECs suggest that unbundling at low prices is needed to permit them to earn a profit, particularly in residential areas where retail rates are often below-cost.<sup>38/</sup> However, as the D.C.

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<sup>35/</sup> *USTA*, 290 F.3d at 425 n.2.

<sup>36/</sup> *Id.*.

<sup>37/</sup> Qwest Comments at 50-59.

<sup>38/</sup> *See, e.g.*, AT&T Comments at 224 (claiming that a UNE loop-based strategy "could not possibly be applied to the residential market, where margins are smaller"); Assoc. of Communications Enterprises Comments at 9-15 (arguing that UNE-P is necessary because the

Circuit held, the implicit subsidies found in retail rates, if anything, militate *against* a finding of impairment. As the court explained, the “regulatory hobbling” imposed on ILECs by the subsidization inherent in retail rates requires that ILECs set retail prices in some markets (typically serving business customers) above cost to offset losses from mandatory, below-cost rates in other (usually residential) markets.<sup>39/</sup> CLECs, on the other hand, have “the advantage [of] being free of any duty to provide underpriced service to rural and/or residential customers and thus of any need to make up the difference elsewhere.”<sup>40/</sup> Thus, in business markets where ILECs must charge above-cost rates (and where CLECs tend to focus their efforts), CLECs actually have a competitive advantage that may well “fully offset” any other type of cost disadvantage faced by CLECs — an advantage the Commission must factor into its impairment analysis.<sup>41/</sup>

Further, in those markets where incumbents are required to charge below-cost rates, increased unbundling would not even address the alleged “price squeeze” CLECs claim prevents them from earning a profit. UNEs priced at *cost* — as the Act requires — would not and should not enable CLECs profitably to sell basic service at *below-cost* prices. Rather, as the D.C. Circuit found, CLECs may be able to succeed in such markets by “sell[ing] complementary services (such as long distance or enhanced services) at prices high enough” to make up the difference.<sup>42/</sup> The only other option, as the court observed, would be to set UNE rates “well

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Commission’s resale discount “does not produce statutory discounts adequate to support a viable local service resale offering” and UNE loop-based entry is too costly).

<sup>39/</sup> *USTA*, 290 F.3d at 422.

<sup>40/</sup> *Id.* at 423.

<sup>41/</sup> *Id.*

<sup>42/</sup> *Id.* at 422.

below the ILECs' historic costs," but, in such cases, "given the ILECs' regulatory hobbling, any competition will be wholly artificial."<sup>43/</sup> Of course, CLECs do have the option to resell ILEC service at prices discounted from the ILEC's below-cost retail rates. But ultimately, the proper way to promote viable, sustainable, and fair competition in subsidized markets is to rebalance rates, not to "try[] to create bizarre new UNEs or UNE combinations at uneconomic prices."<sup>44/</sup> The notion that additional elements should be unbundled, or that below-cost UNE rates should be lowered even further, to stimulate competition in areas where retail rates include implicit subsidies is simply indefensible as both a policy and legal matter. That is especially so where the "competition" to be generated would be limited to that between marketing units of different carriers relying on the same network facilities.

**B. The Commission Should Consider the Impact of Its Unbundling Determinations on Incentives for Facilities Investment.**

In determining which network elements must be unbundled, commenters generally agree that the Commission should consider the policy goal of promoting facilities investment by both CLECs and ILECs. AT&T, WorldCom, and other CLECs put forth the counter-intuitive proposition that the widespread availability of UNEs does not discourage facilities-based entry, but instead spurs deployment of new facilities by both CLECs and ILECs.<sup>45/</sup> This assertion is contrary to common sense, basic economic principles, and factual developments since the 1996 Act was passed.

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<sup>43/</sup> *Id.*

<sup>44/</sup> John Haring & Harry M. Shooshan, Strategic Policy Research Report, *Reorienting Regulation: Toward a More Facilities-Friendly Local Competition Policy* 29 (Apr. 3, 2002) (submitted as Attachment A to Qwest's initial comments) ("Haring & Shooshan").

<sup>45/</sup> See, e.g., AT&T Comments at 44-87; WorldCom Comments at 88-90; Covad Comments at 37-38; Sprint Comments at 11; ALTS Comments at 18-20.

Where a CLEC could otherwise obtain an element from non-ILEC sources, requiring the unbundling of the element (particularly at understated prices set by state commissions) creates significant disincentives to investment in that type of facility by both CLECs and ILECs. In that situation, any CLEC seeking to provide service must make the decision whether to lease the UNE or obtain the facility from a non-ILEC source. As explained in Professor Farrell's declaration, "unbundling can slow the growth of competition by substituting for, rather than complementing, facilities investment."<sup>46/</sup> If a facility that the CLEC could reasonably obtain from non-ILEC sources is also available as a UNE at cost-based (or even lower) prices, a CLEC will have significant incentives (*e.g.*, lower investment risk) to lease the UNE instead of investing in the alternative facility, which ultimately will decrease the range of competition.<sup>47/</sup> The D.C. Circuit recognized that, by "assum[ing] that universal access to virtually all network elements would prove attractive (leading to the rapid introduction of 'competition')," the Commission had acknowledged this reality.<sup>48/</sup>

As for the ILECs, forcing them to provide unbundled access to their facilities (particularly new facilities used to provide advanced services) at discounted TELRIC prices produces a "greatly reduced incentive to take the risk associated with that investment,"<sup>49/</sup> because the ILEC knows that its competitors will be able to capture at least some of the ILEC's

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<sup>46/</sup> Farrell Declaration ¶ 5; *see also* Haring & Shooshan at 6 ("[U]nbundled elements are a *substitute* as well as a complement for facilities-based competition.").

<sup>47/</sup> *Id.*

<sup>48/</sup> *USTA*, 290 F.3d at 425. Furthermore, as discussed below, AT&T's suggestion that unbundling is nevertheless necessary to serve as a "transitional mechanism" so that a CLEC can obtain a large enough customer base to justify investment in its own facilities is incorrect for a variety of reasons.

<sup>49/</sup> Haring & Shooshan at 11.